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CHARLES ELMORE CROPL

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

No. 232.

BRONX BRASS FOUNDRY, INC.,
Appellant.

—vs.—

IRVING TRUST COMPANY, as Trustee in Bankruptcy of J. R. Palmenberg's Sons, Inc.,
Respondent.

APPEAL FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

APPELLANT'S BRIEF

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The Alpert Press, 138 Livingston Street, Brooklyn, N. Y. Tel. TRiangle 5—1058-1059

SUBJECT INDEX.

PAGE

Opinion Below 1

Jurisdiction 1

Concise Statement of Case 2

Assignment of Errors 3

Summary of Argument 4

Argument 5

A. The Denial of the Application to Withdraw the Proof of Claim Was Error, Since No Legal Prejudice Would Result Therefrom 5

B. A Creditor Who Receives a Part Payment of His Claim Does Not Receive a Preference If at the Time of Payment the Debtor's Estate, Valued as a Going Concern, Would Be Sufficient If Distributed, to Pay All Other Creditors of the Same Class an Equal Proportion of Their Claims 11

Conclusion 27

Table of Cases and Textbooks Cited.

	PAGE
Adams v. Champion, 55 Sup. Ct. 399	20
Altschuler v. Lipschitz, 113 N. Y. Sup. 1058	27
Black on Bankruptcy	23
Brittain Dry Goods Co. v. Bertenshaw, 66 Kansas 734	19
Butler v. Goembel, 143 Fed. 295	13
Citizens' Bank v. Prescott, 221 App. Div. (N. Y.) 426	26
Commerce Guardian Savings Bank & Trust Co. v. Devlin, 6 Fed. (2nd) 518	25
Deeley v. Cincinnati, 23 Fed. (2nd) 920	8
Ex Parte Skinner & Eddy, 265 U. S. 86	4, 5, 6, 11
Gilbert's Collier on Bankruptcy	23
Haas v. Sachs	14, 19, 20
Herzberg v. Riddle, 171 Ala. 368	19, 23
In Re Stewart, 178 Fed. 463	8
In Re Strickland, 167 Fed. 867	8
King v. Ross, 28 App. Div. 371 (N. Y.)	27
Mansfield v. Sternberg, 38 Fed. (2nd) 614	14, 19
Pennsylvania v. Globe, 121 Fed. 1015	7
Remington on Bankruptcy	10, 19
Scholl v. Rodgers, 51 Fed. (2nd) 971	8, 10
Slayton v. Drown, 93 Vermont 290	19, 24
Whitney v. Dresser, 200 U. S. 535	27
W. S. Peck v. Whitmer, 231 Fed. 893	14, 19

Statutes.

Bankruptcy Act of 1898, Sec. 60, subs. (a) and (b)	15
Bankruptcy Act of 1898, Sec. 57, sub. (g)	16

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Opinion Below.

The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 76 Fed. (2nd) 935.

Jurisdiction.

This Court granted a writ of certiorari to Appellant on October 14, 1935. Jurisdiction is invoked under Section 240 (A) of the Judicial Code as amended by the Act of February 13, 1925 (U. S. C. Title 28, Sec. 347a).

Concise Statement of the Case.

This is an appeal by a creditor in a bankruptcy proceeding from an order of the Circuit Court of Appeals for the Second Circuit which affirmed an order of the District Court, which in turn affirmed an order of the Referee in Bankruptcy. The order of the Referee in Bankruptcy denied the application of the Appellant (creditor) to withdraw its claim against the bankrupt estate, and expunged the claim upon the ground that Appellant received a preference.

On July 18, 1933, an involuntary petition in bankruptcy was filed against J. R. Palmenberg's Sons, Inc.; and on August 10th, 1933, it was adjudicated a bankrupt in the United States District Court for the Southern District of New York (R., pp. 4, 6, fol. 6). One of its creditors was the Bronx Brass Foundry, Inc., the appellant here. It filed a proof of claim for the sum of $2,101.10, representing the balance due on a debt of $3,101.10 (R., p. 2). Payments totalling $1,000. had been paid to it by the debtor, within the proscribed four months period prior to bankruptcy, as follows:

Date	*Amount*
April 24, 1933	$250.00
May 1, 1933	250.00
May 19, 1933	100.00
May 26, 1933	100.00
June 9, 1933	100.00
June 16, 1933	100.00

(Trustee's Exhibit I, R., p. 68). (Another payment of $100.00 was made during the period.) (R., p. 7, fol. 12.)

Objections were filed by the Trustee to the allowance of the claim upon the ground that a preference had been obtained by the claimant as a result of said payments (R., p. 4).

Hearings upon the question whether there had been a preference were held before Referee John E. Joyce. At the third session or hearing on the objections, the Referee ruled, over the objection of the Appellant, that the objection to the

claim of Theodore Palmenberg, another creditor, be consolidated and heard together with the objection to this claim. Before the Trustee had rested its case, and promptly after this ruling, appellant withdrew its proof of claim (R., p. 59). The Referee permitted the notice withdrawing the claim to be filed (R., p. 60). He was then pressed by both sides to announce whether he would permit the withdrawal. He failed to decide the question at that time and asked the attorney for the creditor whether he wished to remain. On receiving a negative response, he said he would hear the evidence from the Trustee (R., pp. 60, 61, fols. 81, 82).

The only evidence adduced by the Trustee as to the value of the business of the bankrupt at the time of the alleged preference (Payments were made between April 24 and June 16th, 1933) related to April 1st, 1933. That evidence consisted of an extract from the books of the bankrupt made by the Trustee's accountant showing the condition of the business as of April 1st, 1933 (Tr. Ex. 4, R., p. 74). This statement showed that the corporation was solvent if the stated book value of the good will were included in the assets; and if the same were excluded, that creditors could be paid more than one-third (45%) of their claims.

Assignment of Errors.

The following is a specification of the errors upon which Appellant will rely upon this appeal:

1. The Court below erred in holding that the creditor, Bronx Brass Foundry, Inc., did not have the right to withdraw its proof of debt.

2. The Court below erred in holding that the Trustee in Bankruptcy would suffer legal prejudice from the allowance of the withdrawal of the proof of debt.

3. The Court below erred in holding valid the rule of the District Court for the Southern District of New York, which makes discontinuances on the part

of plaintiffs discretionary with the Court even though no legal prejudice may be suffered by the defendant; and in applying that rule to bankruptcy proceedings.

4. The Court below erred in holding that the receipt by the Appellant (creditor) of the sum of $1,000.00 representing less than ⅓ of appellant's claim constituted a voidable preference even though the debtor's (bankrupt) estate had, at the time of such payment, or transfer, sufficient assets to have paid all other creditors of the same class an equal or greater percentage of their debts.

5. The Court below erred in holding that the claim of Bronx Brass Foundry, Inc. be expunged unless it pay to the Trustee the sum of $1,000.00.

Summary of Argument.

A. Appellant contends that under the decision of this Court in the case of *Ex parte Skinner & Eddy Corp.*, 265 U. S. 86, a creditor in a bankruptcy proceeding has an absolute right to withdraw his proof of debt at any time prior to judgment thereon. Appellant contends also that the loss of the right on the part of the Trustee of the possibility of obtaining an adjudication of the issue of preference on such hearing is not legal prejudice and constitutes nothing more than the vexation of another law suit on the same issue as defined by this Honorable Court in that case. Consequently, we argue that the Court below erred in denying the application of the creditor, Appellant, to withdraw its proof of debt, which was made during the course of the hearing on the objection to its claim and before the Trustee had rested its case.

B. Appellant contends that a part payment to a creditor within the proscribed four months period, which does not represent a greater proportion of the creditor's claim than other creditors of the same class could receive at the time of payment, does not constitute a voidable preference.

ARGUMENT.

A.

THE DENIAL OF THE APPLICATION TO WITHDRAW THE PROOF OF CLAIM WAS ERROR, SINCE NO LEGAL PREJUDICE WOULD RESULT THEREFROM.

The creditor (Appellant) withdrew its proof of claim immediately upon the decision of the Referee, over the objection of Appellant, consolidating the hearings of the objections to the claim of this creditor and the objections to the claim of Theodore C. Palmenberg (R., p. 59, fol. 79). Whether this ruling over the objection of Appellant furnished reason sufficient to justify discontinuance or withdrawal of the claim, this Honorable Court has held to be immaterial in the case of *Ex parte Skinner & Eddy*, 265 U. S. 86.

The Referee permitted the notice withdrawing the claim to be filed, inquired of Appellant whether it cared to remain, and then ruled that the Trustee could proceed with his evidence (R., p. 61, fol. 82). We contend that the Referee's actions in this regard, were equivocal as well as erroneous.

The Circuit Court of Appeals held that Appellant had no right to withdraw its proof of claim since, if

> "leave to withdraw the claim had been granted, the trustee would have lost the right to litigate, in connection with its motion to expunge, the question whether the creditor had acquired a preference. Though the denial of leave did not entitle the trustee to a recovery, it did establish the fact of preference, and left nothing for subsequent litigation except the amount of the claim. Everything else is *res judicata*. To have deprived the trustee of the right to establish in the summary proceeding the fact of a preference would have been to take away a substantial right" (R., p. 89, fol. 129).

Appellant respectfully maintains that the Circuit Court, in thus stating the rule, has deviated from the well settled

law on the subject and is in error. It is an established principle that a plaintiff in an action at law or in a suit in equity may discontinue at any stage of the proceedings before verdict or judgment, upon payment of costs, as a matter of right, unless legal prejudice will result to the other party. Unless a counterclaim or cross bill is interposed and the defendant is entitled to some affirmative relief, or the other party could be deprived of some substantial right which has accrued to him since the suit was commenced, the plaintiff has an absolute right to discontinue, and his reasons therefor are immaterial. The mere prospect of being harassed and vexed by future litigation of the same kind does not operate to alter the rule. The annoyance to the other party of a second litigation is not ground for refusing to dismiss a bill.

In this case all we have is a proof of claim filed by a creditor. In questioning the claim upon the ground that a preference has been received by the creditor, the Trustee simply interposes what amounts to an objection or defense to the claim. The Trustee is not entitled to any affirmative relief. While the pressing of the issue to judgment might give to the Trustee an adjudication available to it in any action it might bring to recover the alleged preference, the same holds true in every case. But that is no valid reason for denying to a litigant the right to withdraw his claim. Were the Circuit Court correct in its statement of the law, then there could, under no circumstances, be a discontinuance of an action or withdrawal of a bill or proof of claim, for, in every case an adjudication is prevented or delayed. And in every case, a defendant may say that the discontinuance by plaintiff prevents an adjudication of the issue.

This Court, in the case of *Ex parte Skinner & Eddy*, 265 U. S. 86, at pages 92 and 93 states the rule on the subject as follows:

> "At common law a plaintiff has an absolute right to discontinue or dismiss his suit *at any stage of the*

proceedings prior to verdict or judgment, and this right has been declared to be substantial * * *

It is ordinarily the undisputed right of a plaintiff to dismiss a bill in equity before final hearing * * *

'It is very clear from an examination of the authorities, English and American, that the right of a complainant to dismiss his bill without prejudice, on payment of costs, was of course except in certain cases * * * The exception was where a dismissal of the bill would prejudice the defendants *in some other way than by the mere prospect of being harassed and vexed by future litigation of the same kind.*' * * *

The right to dismiss if it exists, is absolute. It does not depend on the reasons which the plaintiff offers for his action. The fact that he may not have disclosed all his reasons or may not have given the real one cannot affect his right." (Italics ours.)

One of the leading cases on the subject, which was cited with approval by the Supreme Court in the latter case, is *Pennsylvania* v. *Globe*, 121 Fed. 1015. The defendant in that case contended that the plaintiff could not discontinue after the hearing had started. The Court overruled this contention, and at page 1016, said:

"The general rule that a complainant has the right to dismiss his bill at any time before hearing is too firmly established to require any citation of authority. It is equally well settled that the annoyance to the defendant of a second litigation is not ground for refusing to dismiss the bill. The only question which can arise in any given case is whether the complainant comes within the exceptions to the rule. These exceptions may be briefly stated: First, where the dismissal would deprive the defendant of some substantial right which has accrued to him since the suit was commenced; second, where the defendant prays for, or is entitled to, some affirmative relief, as, for example, where there is a cross bill * * *

"So far as appears, the defendant is in no way prejudiced by the dismissal of this suit further than his liability to a second suit for the same cause of action.

> "The contention of the defendant is that the general rule giving the right to complainant to dismiss his bill at any time before hearing means 'at any time before setting down for hearing.' Whatever may have been the practice in England, this interpretation of the rule has not been adopted by the federal courts."

This doctrine has been accepted and applied to claims in bankruptcy.

> *In re Stewart* (D. C. N. Y.), 178 Fed. 463;
> *In re Strickland,* 167 Fed. 867;
> *Scholl* v. *Rodgers* (C. C. A. 8 Cir.), 51 Fed. (2d) 971;
> *Deeley* v. *Cincinnati* (C. C. A. 6 Cir.), 23 Fed. (2d) 920.

In the case of *In re Stewart,* 178 Fed. 463, the Court at page 468 says:

> "I do not think it within the power of the court, or referee, to prevent such withdrawal or abandonment of the claim presented. The withdrawal is a matter of right in the creditor, and not a matter of discretion with the referee or judge."

The Circuit Court of Appeals for the Eighth Circuit passed upon a case which is on all fours with the case at bar. *Scholl* v. *Rodgers,* 51 Fed. (2d) 971. In that case a claimant in a bankruptcy proceeding sought to withdraw its claim after objections thereto were filed by the trustee upon the ground of preference. The objection of the trustee was the same as in the case at bar, that the withdrawal would deprive him of the right to a summary adjudication of the issue of preference, which adjudication would be of value, as *res adjudicata* in a suit to recover the preference. The Court held that the creditor's right to withdraw the claim was absolute; *and that deprivation of the opportunity to have a summary disposition of the issue of preference was not legal prejudice.* The Court

reviewed the authorities on the subject and at pages 971, 973, 974, say:

"This is an appeal * * * from an order of the District Court affirming the decision of the referee in bankruptcy refusing the petition of appellant to withdraw its claim filed in the bankruptcy proceeding * * *

"We pass to the other question as to whether appellant had the right as a matter of law to withdraw its proof of claim * * * That a claim filed in a bankruptcy proceeding may be withdrawn is the general rule * * *

"The exception to the general rule as to the right of dismissal is where such dismissal or withdrawal will result in legal prejudice to the other party, which would be the situation if there were a counterclaim at issue or affirmative action sought by defendant * * *

"It is to be noted in the case at bar that no affirmative relief was asked by the trustee. There was no counterclaim. The claim of appellant was objected to because goods had been returned which the trustee claimed amounted to a preference and such preference was urged as a *defense* to appellant's claim. The trial court was of the opinion that the right to have an adjudication of preference made by the referee was an affirmative right and was in the nature of affirmative relief against the claim filed.

"We are unable to agree with this theory. What the trustee loses by a withdrawal of the claim is the opportunity to have determined a question that might be of benefit to him in a suit brought to recover the alleged preference. Is this sufficient to bring this case within the exception to the general rule as to the right to dismiss? * * *

"A plenary suit in equity by the trustee would be necessary to recover the preference, and the referee would have no jurisdiction over such suit * * * The referee could have decided there was a preference and hence that the claim could not be allowed, and that holding affirmed by the district court would of course be of value as *res adjudicata* in an action to recover the preference. However, granting that such adjudication is of some value, the fact remains that the trustee was asking for no affirmative relief, and was in

> no position to demand such relief under the objection filed to proof of claim. The relief asked is merely the establishment of the preference as a defense to the claim, and *we are satisfied that the mere depriving the trustee of the opportunity to have the question of preference passed on in this hearing is not the destruction of any substantial right, or sufficient to constitute legal prejudice and warrant the overruling of the petition of appellant to withdraw its claim.* The trustee would have to go to the home state of appellant (Illinois) to recover this alleged preference *if appellant had never filed its proof of claim,* or if, being filed the referee and the trial court had held there was a preference." (Italics ours.)

The leading authors on the subject are in accord with this view. Remington, in his work on Bankruptcy (3rd ed.) at sec. 754 says:

> "The right of withdrawal is an absolute right of the claimant and is not subject to the discretion of the court."

The objections interposed to a claim upon the ground of preference are designed to prevent a creditor who has been preferred from sharing in the assets of the bankrupt's estate. That purpose is achieved by the creditor voluntarily withdrawing his claim. (*Scholl* v. *Rodgers, supra.*)

Upon the creditor taking such action and withdrawing from the bankruptcy proceeding, the trustee may at once institute suit in the proper tribunal for the recovery of any alleged preference. He would be obliged to bring such a suit whether a claim were filed or not. Therefore, other creditors are in no way prejudiced by the withdrawal, and the administration of the bankrupt estate is not retarded.

The Circuit Court points to a rule of the district court governing voluntary withdrawals, and holds that the rule controls, with the assertion that the matter is procedural rather than substantive. The holding in effect nullifies the decision of this Honorable Court on the subject, and, there-

fore, cannot be sustained. If the right to withdraw is procedural, subject to exclusive control by the court where the action is pending, then, whether such control be expressed in the form of a rule promulgated or in a decision of the particular court, there would be no basis for an appeal to or consideration by an appellate court of the question of withdrawal. The very fact that appellate courts, including this Honorable Court, have rendered judgments upon the question is proof sufficient that no mere matter of procedure is involved. In the case of *Ex Parte Skinner* v. *Eddy,* 265 U. S. 86, 92, this Court said (we repeat):

> "At common law a plaintiff has an absolute right to discontinue or dismiss his suit at any stage of the proceedings prior to verdict or judgment, and this right has been declared to be *substantial* * * *." (Italics ours.)

Appellant respectfully contends, therefore, that the Court below committed error in affirming the order of the Referee and District Court refusing to allow the creditor to withdraw its claim or proof of debt.

B.

A CREDITOR WHO RECEIVES A PART PAYMENT OF HIS CLAIM DOES NOT RECEIVE A PREFERENCE IF AT THE TIME OF PAYMENT THE DEBTOR'S ESTATE, VALUED AS A GOING CONCERN, WOULD BE SUFFICIENT IF DISTRIBUTED, TO PAY ALL OTHER CREDITORS OF THE SAME CLASS AN EQUAL PROPORTION OF THEIR CLAIMS.

The problem presented on this appeal concerns the application of Section 60 of the Bankruptcy Act to a part payment of a debt within the proscribed four months' period.

Where a creditor receives full payment of his claim during that period there can be no question that he has received

a preference that may be voidable if he knew or had reasonable cause to believe that the debtor was then insolvent, because insolvency means that the debtor can not pay all his creditors in full.

In this case the Appellant had a claim in the sum of $3,101.10 against the bankrupt. It filed its claim for the balance of $2,101.10 (R., p. 2). Within the four-month period it received payments on account as follows:

Dates	*Amounts*
April 24, 1933	250.00
May 1, 1933	250.00
May 19, 1933	100.
May 26, 1933	100.
June 9, 1933	100.
June 16, 1933	100.

(Trustee's Ex. 1, R., p. 68). Another payment of $100 was made during that period (R., p. 7). These payments aggregated less than ⅓ of its claim.

We do not raise any issue as to knowledge of insolvency on this appeal. We contend that the evidence shows that there was no preference in fact effected by any single payment on account nor by the total payments on account because the evidence adduced by the Trustee, viewed most favorably to the Trustee, showed that at the time these payments were made the debtor could have paid all creditors at least 45% of their claims, if the assets of the debtor were then distributed among the creditors.

We contend that since there was no preference in fact there can be no voidable preference. In other words, mere knowldge of insolvency does not convert into a voidable preference a part payment, which does not represent a greater proportion of the debtor's assets than other creditors could then receive. The Bankruptcy Act requires proof of two important elements to make out a voidable preference. The first is, that the transfer should *at the time of transfer* oper-

ate to give to the creditor a greater percentage of the debtor's assets than other creditors of the same class could then receive. Second, that the creditor *then* knew or had reasonable cause to believe that the debtor was insolvent and that such transfer would then effect a preference. We contend in this case that both elements are completely lacking.

The only evidence adduced by the Trustee as to the financial condition of the debtor at the time of transfer was purely of documentary character, consisting of a transcript of the books of the debtor, showing its financial condition as of April 1st, 1933 (Trustee's Ex. 4, R., p. 74). If we eliminate the item of good will this exhibit shows that the assets amounted to $127,398.12 and the liabilities to $283,652.75. The percentage of assets to liabilities was more than 45%. Appellant received less than 33% of its claim. Consequently, it did not *then* receive a greater proportion of its debt than other creditors of the same class could then have received if the debtor's estate were distributed at the time these payments were made to Appellant.

Appellant here is viewing this exhibit most favorably to the Trustee by eliminating the item of good will. The evidence showed that the debtor continued in business down to the time of bankruptcy which was July 18th, 1933; that the bankrupt had been in business for 81 years (R., p. 49, fol. 66); that during that time it had advertised on a rather large scale (R., pp. 50, 51, fol. 67). There is no competent evidence in the record that the good will was worthless. There was substantial evidence which we have already referred to indicating that the good will was a substantial asset of the bankrupt. If the good will was worth $400,000, the figure at which it was carried on the bankrupt's books, or even half that amount, the debtor was fully solvent at the time the payments were made to Appellant. The weight of authority holds that the assets are to be valued at their worth as a going concern. Thus, in *Butler* v. *Goembel*, 143 Fed. 295, at page 297, the Court says:

> "The valuation for the test of solvency or insolvency under the issue must relate to the conditions, as a going concern, when the alleged preference was given and not to the mere dead matter of the plant after bankruptcy intervened * * *."

To the same effect:

> *Haas* v. *Sachs,* 68 Fed. (2d) 623;
> *Peck* v. *Whitmer,* 231 Fed. 893;
> *Mansfield Lumber* v. *Sternberg,* 38 Fed. (2d) 614.

Nevertheless, we repeat, even if this item be eliminated from consideration for the sake of argument, the proof adduced by the Trustee did not establish that Appellant received a preference in fact.

We respectfully maintain that the Circuit Court of Appeals has placed an unwarranted and untenable interpretation upon subdivisions (a) and (b), Section 60 of the Bankruptcy Act. The Circuit Court of Appeals in its opinion states that:

> "Whether a creditor of an insolvent has received an unlawful preference is not to be determined by what the situation would have been if the estate had been completely liquidated and distributed among all the creditors at the time when the alleged preferential payment was made, but upon whether the ultimate result of a payment by a known insolvent 'will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class'" (R., p. 91, fol. 131).

The opinion points out that:

> "though the proof did not show that when it was paid the $1,000 or 1/3d the amount then due it, the assets were insufficient to pay the other creditors 1/3d of the amount of their claims" (R., p. 88, fol. 128)

the payment to the creditor nevertheless constituted a voidable preference because the Appellant by sharing in the division of the bankrupt's estate would receive a dividend. Thus, it contends the ultimate result of the payment would be that the creditor, Appellant, would receive a greater proportion of its debt than other creditors of the same class would receive. The Court below makes the test of voidable preference, the ultimate result of a payment. It gave an illustration in its opinion, based upon an hypothesis, to demonstrate that the final or ultimate result of the payments on account received by Appellant would give it a greater percentage of the assets than other creditors of the same class.

We respectfully say that the Court below fell into error in its interpretation and that the hypothetical example given in its opinion demonstrates the error of its construction to a certainty.

The Court below attempts to justify its conclusion by the provisions of subdivision (a) of Section 60 of the Bankruptcy Act. The pertinent provisions of Section 60 of the Bankruptcy Act (11 U. S. C. Sec. 96) are:

> "(a) A person shall be deemed to have given a preference if, being insolvent, he has, within four months before the filing of the petition * * * made a transfer of any of his property, and the effect of * * * transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class * * *.
>
> "(b) If a bankrupt shall have * * * made a transfer of any of his property, and *if, at the time of transfer* * * * and being within four months before the filing of the petition in bankruptcy * * * the bankrupt be insolvent and the * * * *transfer then operate as a preference,* and the person receiving it or to be benefited thereby * * * shall *then have reasonable cause to believe* that the enforcement of such * * * transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person." (Italics ours.)

We believe that the Court below fell into error because of grammatical misconstruction of subdivision (a). The words "will be" as used in subdivision (a) of Section 60, refer to consequences of transactions that will take place after the enactment of the law. They do not refer to the *future* consequences of transactions condemned by this section. This must be so in view of the precise definition of voidable preferences given in subdivision (b) which is clearly at odds with the construction placed upon subdivision (a) by the Court below. If the paragraph contained in subdivision (a) had been written in the present tense rather than the future tense, we believe there would have been no misunderstanding. The language of this section, because it is written in the future tense, has been erroneously construed to give condemnation to future consequences of transactions. When subdivisions (a) and (b) are read together, the intent is plain that transactions to be judged as voidable preferences, are to be judged by the then present consequences of such transactions and not by future consequences.

In any event subdivision (b), which sets forth the terms under which a preference may be avoided and recovered specifically requires that the Trustee prove that *at the time of transfer* the "transfer *then* operate as a preference" and the creditor "*then* have reasonable cause to believe that the enforcement of such transfer would effect a preference." It is clear from its context that subdivision (a) does not govern recovery of voidable preferences from creditors. Any doubt with respect thereto must be dispelled by the fact that the four elements contained in subdivision (a) are contained in subdivision (b) with the addition of the crucial word "then" and the additional requisite of knowledge or reasonable cause to believe on the part of the creditor of the debtor's insolvency; and by the fact that Section 57, subdivision (g), governing the allowance of claims specifies that:

> "the claims of creditors who have received preferences *voidable under section sixty subdivision (b)*

> * * * shall not be allowed unless such creditors shall surrender such preferences * * *." (Italics ours.)

The legislative intent to have subdivision (b) govern the determination of voidable preferences is clear from this section of the act.

The illustration given by the Court below to support its holding, does not in fact support it. The Court below pointed out that if there were a distribution of 50% in this estate to all creditors that the receipt of such sum by Appellant would render the previous payment preferential because by adding such dividend to the previous payment the creditor would receive a greater proportion of his debt than other creditors of the same class would ultimately receive. In effect the Court rules that the filing of a claim in bankruptcy is the factor which converts an otherwise valid payment into a voidable preference. Because, if Appellant had not filed a claim in this bankruptcy proceeding it would not receive any dividend which, when received, would make the previous payment preferential. Such a construction, it is plain, cannot be reasonably inferred from the language of Section 60 of the Bankruptcy Act.

We have this consequence to the Court's decision: That no matter how small the percentage of his claim a creditor may receive from the debtor on account before bankruptcy, and no matter how large the dividend percentage available for distribution to creditors in the subsequent bankruptcy proceeding, the creditor receiving the part payment necessarily gets a preference which may be avoided, if there was another creditor who did not receive as great a percentage of his claim on account and the assets available for distribution to creditors in the bankruptcy proceeding are not sufficient to pay all creditors in full. With bankruptcy, all creditors receive the same percentage of their claims from the assets of the bankrupt's estate available for distribution to them. So that, applying the rule of the court below, were ninety-nine creditors to receive on account, prior to bank-

ruptcy, between 5 and 10 per cent of their claims, with the assets of the debtor sufficient at such time to pay all creditors as much as 99 per cent of their claims, there would, nevertheless, be, in the event of bankruptcy within four months thereafter, a voidable preference in the case of each one of the ninety-nine creditors were it shown that one creditor had received a single penny less than the minimum percentage received by the others on account. Again, where one creditor receives a part payment of 1 per cent of his claim, no other creditors receiving part payments on their claims, the creditor necessarily receives a voidable preference, even though at such time, or in the distribution of the debtor's estate after bankruptcy, the assets are sufficient to pay all creditors 99 per cent of their claims. Surely no such situation was ever contemplated by the framers of the Bankruptcy Act, and it is clearly at war with the plain provisions of Section 60 (b).

Under the rule laid down by the Court below a creditor who receives a part payment would be charged with knowledge of what other creditors have received and may receive up to the time of bankruptcy; what creditors of the same class there would be at the time of bankruptcy; what other creditors may do concerning obtaining part payment of their claims. It would burden such a creditor with the results of speculations on the part of a debtor from the time of payment down to the time of bankruptcy; with losses that the debtor may sustain through fire, robbery, sickness, and other risks of business and life. The creditor would be required to foresee whether market prices would go up or down; whether patents might be invented which would destroy the value of the debtor's business; whether the debtor may lose money or make money up to the time of bankruptcy, and finally the creditor would be charged with knowing what the estate of the debtor would yield after it had gone through the shrinking processes of the bankruptcy courts. We submit that such an onerous rule was never contemplated by the

Congress and can not be fairly inferred from the language of Section 60 of the Bankruptcy Act.

The evidence in this case showed that other creditors could have received 45% of their debt at the time Appellant received only 33% of its debt. *There is no proof in the record that creditors of the same class will receive less than ⅓ of their claims from the bankrupt estate.*

Furthermore, in this case, it appears that the creditor, Appellant, received the total of $1,000 during a course of about six weeks between April 24th and June 16th, 1933; that the largest payment on account represented less than 10% of the total claim; and most of the payments represented payments on account of about 3% each. We have shown that the aggregate of the payments made amounted to less than ⅓ of the total claim of Appellant and that the aggregate was not preferential in fact. *A fortiori* each individual payment when made certainly did not represent a greater proportion of the Appellant's claim than other creditors of the same class could then have received. The case of *W. S. Peck & Co.* v. *Whitmer,* 231 Fed. 893, from which we quote later, is authority for the proposition that it is necessary for the Trustee to prove in such case that each of the payments so made were, by themselves, preferential in fact; and that at the time that each particular payment was made the creditor had knowledge or reasonable cause to believe that the enforcement of the payment would effect a preference.

The weight of authority is contrary to the holding of the court below.

Haas v. *Sachs,* 68 Fed. (2d) 623;
W. S. Peck & Co. v. *Whitmer,* 231 Fed. 893;
Mansfield Lumber Co. v. *Sternberg,* 38 Fed. (2d) 614;
Herzberg v. *Riddle,* 171 Alabama 368;
Slayton v. *Drown,* 93 Vermont 290;
Brittain Dry Goods Co. v. *Bertenshaw,* 66 Kansas 734;
Remington on Bankruptcy, Sec. 1812.

The cases of *Haas* v. *Sachs* and *Mansfield Lumber Co.* v. *Sternberg* are cited with approval by this Court in the case of *Adams* v. *Champion,* 294 U. S. at page 235, 55, S. C. at page 401.

In the case of *Haas* v. *Sachs* (C. C. A.—8th Cir.), 68 Fed. (2nd) 623, at pages 625, 626, the Court, in construing this section of the bankruptcy law in a case where a creditor received *part payment* of its claim said:

> "Appellant received in this payment exactly 10% of his claim. * * *
>
> "In this condition of the record, appellant contends that at the time he received the $2,000.00 payment, the bankrupt had assets more than sufficient in value to pay 10% of all his indebtedness, and hence it is argued there was no voidable preference. * * *
>
> * * * * *
>
> "If enough assets remain after a transfer to one creditor to give other creditors in the same class as great or greater percentage of their claims, then no voidable preference results. *W. S. Peck & Co.* v. *Whitmer* (C. C. A. 8), 231 F. 893, 897; *Mansfield Lumber Co.* v. *Sternberg* (C. C. A. 8), 38 F. (2nd) 614, 617.
>
> "This Court has held that whether the effect of the transfer will be to enable the creditor receiving it to obtain a greater percentage of his claim than other creditors of the same class, is to be determined as of the date of the actual transfer, and not as of some future date when later events have altered the assets or liabilities, or when court liquidation may have caused shrinkage of values and other losses."

The same Court passed upon the case of *Peck* v. *Whitmer,* 231 Fed. 893, which case involved also the question as to whether a creditor who received a *series of part payments* of his claim, obtained a voidable preference. The creditor in that case received partial payments within the proscribed period, aggregating about eighteen (18%) percent of its claim. The payments were made about a week apart. It was shown that there was sufficient assets even at bankruptcy

to make a payment of thirty (30%) percent to all creditors of the same class and that at the time the payments were made to the creditor, the estate if then liquidated would have paid sixty (60%) percent to all creditors. The Court there held that the creditor had not received a preference and that in determining whether a preference is obtained by a creditor who receives a part payment, the estate of the debtor or bankrupt at its value at the time of the transfer is the test of preference, and not the value of the estate after bankruptcy. It also held that where part payments are made, the value of the estate at the time of each particular payment was the test as to whether each particular payment effected a preference. We quote from the opinion of *Peck* v. *Whitmer:*

> "It thus appears that it is not sufficient to defeat the allowance of the claims of appellants that they received preferences as defined by law, but it also must appear that at the time the payments were made appellants had reasonable cause to believe that the enforcement of the payment or transfer would effect a preference.
>
> "Therefore, the burden of proof was upon the trustee to show by a fair preponderance of the evidence (1) that the bankrupt was insolvent at the time the several payments were made; (2) that the payments so made enabled appellants to receive a larger percentage of their respective debts than any other creditor of the same class; (3) *that at the time each particular payment was made, appellants had reasonable cause to believe that the enforcement of the payment or transfer would effect a preference.*
>
> "Where in any particular case it is shown that a creditor at the time he receives full payment of his debt knows that his debtor is insolvent or has knowledge of such facts, which investigated would show insolvency, it necessarily results that the creditor had reasonable cause to believe that the enforcement of the transfer would effect a preference. But in a case where the transfer or payment amounts to but a small percentage of the total debt, knowledge of the insolvency of the debtor or of facts which if investigated

would lead to such knowledge is not conclusive upon the question as to whether the creditor had reasonable cause to believe that the enforcement of the transfer or payment would effect a preference.

* * * * *

"It thus appears that the insolvency must exist at the time of the transfer, and the transfer must then operate as a preference and the creditor must then have reasonable cause to believe that the enforcement of the transfer would effect a preference. Let us assume that the record shows that the bankrupt was insolvent at the time the several payments were made, and that appellants had knowledge of such facts, which if investigated would have led to a knowledge of the insolvency, there would still remain to be established two important and material facts, viz., that the payments at the time they were made to appellants enabled them to receive a larger percentage of respective debts than any other creditor of the same class, *and that at the time each particular payment was made appellants had reasonable cause to believe that the payments would have this effect.* The enforcement of the transfer when such transfer is in the form of the payment of money simply means if the payment shall stand as a legal payment.

"We fail to find any evidence in the record that the appellants at the time they received the several payments had reasonable cause to believe that the enforcement thereof would effect a preference.

* * * * *

"Taking the record as it stands, how could the appellants be held to have believed that if the estate of the bankrupt had been distributed at the time of these payments it would not have given every creditor a greater percentage of their debts than they were receiving. The estate of the bankrupt at the time the payments were made would have paid about 60 percent. on the dollar. The creditor who receives a partial payment on his debt, so far as the question of his having reasonable cause to believe that the enforcement of the payment would effect a preference is concerned has the right to look at the bankrupt's estate

> at the time the payment is made, bankruptcy may never occur; but if it does, the creditor may not be charged with a knowledge of what an estate will pay out after it has undergone the shrinking process of the courts." (Italics ours.)

This doctrine is supported by the authorities. Black, on Bankruptcy, at pages 622, 623, says:

> "If the creditor knows or has reasonable ground to believe that the debtor is insolvent, then it may be inferred without further proof that he also has reasonable ground to believe that the enforcement of the judgment or transfer which he takes will effect a preference, such being its natural and inevitable result, at least if the payment, transfer, or security puts him in a position to collect the whole amount of his claim. But if the preference alleged consists only in giving to one of the creditors a part of the amount of his claim, then he must have reasonable ground to believe that other creditors will not be able to secure so large a dividend, and even positive knowledge of the debtor's insolvency may not be sufficient to warn him of this. For though the debtor may not be able to pay his debts in full, yet he may be able to pay to all his creditors at least as large a share of their claims as goes to the creditor alleged to have been preferred."

Similarly, in Gilbert's Collier on Bankruptcy (2nd ed.), on page 895 it is said:

> "If the transaction results in the *pro rata* distribution of the debtor's estate among all his creditors it does not create a preference, although the creditor had notice of the debtor's insolvency."

This problem was also passed upon in the case of *Herzberg* v. *Riddle,* 171 Ala. 368, where on page 374 the Court said:

> "If a man's debtor who is solvent pays him his debt in full, surely there is no ground to suspect a preference because every other debtor can compel payment; but if he accepts all of his debt, *or a large part thereof,* from a debtor known or suspected to be hopelessly

insolvent, then he may know or have reasonable cause to believe that a preference is made * * * But, if he accepts only that part of his debt to which he would be entitled if all the property liable to the debts should be apportioned among the creditors, then, of course, there is no preference * * * though the debtor may be hopelessly insolvent." (Italics ours.)

In the case of *Slayton* v. *Drown,* 93 Vermont 290, the Court, in construing these provisions of the Bankruptcy Act, said:

"The fault in the plaintiff's contention that the payment received by the alleged preferred creditor is to be measured by what the other creditors received on the final settlement of the bankrupt estate is apparent when considered in connection with a few familiar illustrations. Suppose that, after the alleged payment, the debtor in the meantime mismanages the business, or successfully conceals a portion or the whole of his property, or a fire destroys his assets, or a world war ruins his business, and that, in the final settlement, the expenses of the management and settlement of the estate, involving an expensive litigation, leaves nothing, or only a small part to be distributed among the other creditors, in such circumstances, could it be said that a creditor having received a payment on his debt of no greater percentage than the bankrupt was 'then' able to pay all his other creditors of the same class was a preference, and such fact reasonable ground to believe that such payment would effect a preference even though it should ultimately turn out on the closing up and final settlement of the bankrupt estate that nothing or only a small per cent., much less than the per cent. paid the alleged preferred creditor, was left to pay the other creditors? Can it be reasonably inferred that it was the intention of Congress in the passage of the Bankruptcy Act to make a payment of the bankrupt to one of his creditors, of a sum not exceeding a per cent. which he was able to pay from his assets subject to the payment of his debts, to each of his other creditors, a preference voidable by the trustee? Must the preferred creditor be charged with a belief that no

one would have entertained at the time the payment was made? We think the act was not passed with any such result intended. It cannot be conceived that the act contemplated that the creditor receiving a payment from an insolvent debtor should be charged with reasonable cause to believe that the payment would effect a preference, when, if the exact facts had been known to him at the time the payment was made, they would not have disclosed that the payment was a preference. To establish that the defendant had reasonable cause to believe that the payment would effect a preference, the burden was upon the trustee to show that such was the effect of the payment at the time it was made; for otherwise there would be no basis for the belief.

"In the case at bar the plaintiff's own evidence disclosed that the payment to the defendant was of no greater per cent. of his debt than the insolvent was 'then' able to pay to his other creditors. Indeed, he could have paid to them a much larger per cent. of their debts at that time than he paid to the defendant, while up to the present time no one knows what the bankrupt's estate will be able to pay the creditors on final settlement.

"The portion of the charge excepted to made the recovery to depend, not upon the defendant's having received a greater percentage of the bankrupt's estate than other creditors of the same class would have received if the assets had then been distributed *pro rata* but upon his having received more than other creditors of the same class might ultimately receive on the final settlement of the estate. As we have seen, this was error, and harmful error, and the exception to the charge must be sustained."

The Court below relies upon *Commerce Guardian Trust & Savings Bank* v. *Devlin*, 6 Fed. (2d) 518 (C. C. A.—6) as supporting its construction of Section 60 of the Bankruptcy Act. This case states no rule for determining preferences. The remarks of the Court in that case at page 537:

"We see no merit in the suggestion that the bank got no greater percentage on its own claim (about 48 per

> cent.) than creditors generally would have had, if we accept the estimate of 50 per cent. made by the bankrupt's bookkeeper. The bank actually received 100 per cent. on $6,300 of its claim, and, if the preferences were upheld, would be entitled to receive upon the balance of its claim the same percentage as other creditors of the same class."

are difficult to understand. Is not every part payment 100 per centum of itself? How can it be anything else? If that be the test, then a part payment of one per centum of a debt would be preferential because, standing by itself, it is 100 per centum of itself; and thus would be voidable even though the debtor's estate could, at the time of payment, have paid all other creditors 99 per centum of their claims.

The trustee contended in the Court below that because appellant refrained from further participation in the proceeding after the Referee permitted its notice withdrawing the claim to be filed, that the order entered by the Referee was in the nature of a default order and, therefore, not appealable. We respectfully submit that this contention is without merit.

Appellant duly took exception to the ruling allowing the trustee to proceed with his evidence (R., p. 61, fol. 83). The only way by which an aggrieved party may review a ruling of a referee, under the Bankruptcy Act, is by petition for review to the District Court (Bankruptcy Act of 1898, *Sec. 2,* subd. 10). This procedure was duly taken by appellant to review the ruling of the Referee denying its application to withdraw and holding that it had received a preference (R., p. 78).

There was no default suffered by appellant. Failure to participate further in a trial is not a default. Thus, it has been held that one who applies for an adjournment, which is denied, has participated in the trial and can only review the ruling by appeal from the judgment.

> *Citizens Trust Co.* v. *Prescott,* 221 App. Div. 426 (N. Y.);

King v. *Ross,* 28 App. Div. 371 (N. Y.);
Altschuler v. *Lipschitz,* 113 N. Y. Supp. 1058.

Moreover it is well settled that the proof of debt makes out a *prima facie* case. *Whitney* v. *Dresser,* 200 U. S. 535. Appellant had filed its proof of debt and thus made out a *prima facie* case. The burden of proof rests upon the trustee to establish the defense whereby the claim is sought to be expunged. The failure to produce such evidence prevents the Referee and the District Court, from expunging the claims. *Whitney* v. *Dresser,* 200 U. S. 535. We contend that the Trustee has failed, as a matter of law, to adduce evidence sufficient to establish its defense of preference. The ruling sustaining this defense could only be reviewed by petition to review in the District Court.

CONCLUSION.

THE ORDER APPEALED FROM SHOULD BE REVERSED, AND THE APPLICATION OF APPELLANT TO WITHDRAW ITS PROOF OF CLAIM SHOULD BE GRANTED WITH COSTS.

Respectfully submitted,

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